SIGNIFICANT DEVELOPMENTS

LEGISLATIVE DEVELOPMENTS

STATE LEGISLATION ENACTED

Text of these laws can be viewed on the Web page of the Michigan Legislature: *www.MichiganLegislature.org.*

1999 PA 276 (effective 3/1/00) establishes a new Banking Code of 1999 that recodifies the Michigan law governing banking and repeals the Banking Code of 1969. The recodification was proposed to accommodate the evolution of financial institutions' products, structures and technology in the past three decades and to provide the Bureau and banks with the flexibility they will need to be effective in the next millennium. It represents the results of several years of discussions between the financial services industry and the Bureau. Highlights of the new law can be viewed on the Bureau's Web page at: *http://www.cis.state.mi.us/fib/.*

1999 PA 275 (effective 1/5/00) modernized the Consumer Financial Services Act. This law provides lenders a way to obtain one license to provide a variety of financial services that ordinarily would require up to six separate licenses. The new law eliminates branch office licensing and restructures regulatory fees in conformance with changes made in 1996 and 1997 in the Mortgage Brokers, Lenders, and Servicers Licensing and Secondary Mortgage Loan Acts. PA 275 also provides the Commissioner with new supervisory tools.

1999 PA 18 (effective 4/29/99) amends the Home Solicitation Sales Act to refine a 1998 amendment that inadvertently expanded the act's coverage to some transactions closed on a business' established premises. The amendment exempts consumer transactions with depository institutions and transactions consummated on a business' premises from the act and defines the term ''written solicitation.''

1999 PA 234 (effective 12/28/99) amends the Michigan Credit Union Act to reduce the Michigan residency requirement for directors of corporate central credit unions. The previous law required that all directors of a corporate central credit union be residents of this state. If Michigan's corporate central credit union merged with the corporate central credit union of another state, Michigan would be unlikely to be chosen as the domicile of the merged institution because the other credit union would want to have some board representation. The new law requires only that one director of a Michigan corporate central credit union be a resident of Michigan.

1999 PA 164 makes it a felony to prepare or submit an application for a loan in another person's name without that person's authorization. It exempts regulated financial institutions and their affiliates, officers, employees, and agents who have no prior actual knowledge that an application is being submitted without the authorization of the named applicant. A related measure, **1999 PA 166,** imposes similar strictures on those who act as mail drops for such activity or receive the proceeds of fraudulent credit applications. Tie-barred to these bills, **1999 PA 165,** established sentencing guidelines for the felonies established under Public Acts 164 and 165. All three laws are effective 2/3/00.

1999 PAs 123, 132, 133, and 134 establish a procedure for speeding the tax-delinquent property reversion process. The existing process could take as long as six years, during which time a property might be abandoned and deteriorate. The new laws provide that for taxes levied after December 31, 1998, tax-delinquent property will be subject to forfeiture, foreclosure, and sale over a three-year process. A two-year accelerated process is created for properties that have been determined to be abandoned.

1999 PAs 84, 127, 128, 129, 130, and 131 create a Michigan urban homesteading program modelled on the lines of the nineteenth century federal program that settled the West. Under the program, qualified individuals could take over abandoned homes and bring them up to code or construct a home on vacant land and acquire title to the property. A person who rents a homestead property (which may include single and multi-family public housing) at fair market value for five years could acquire title to the property for $1.00.

Qualified buyers, among other criteria, would need to be employed, make sure that school-age children in the household attend school regularly, be drug-free, not have been sentenced or imprisoned for a felony within the past year or be on probation for a felony, and have income below the Michigan median.

Local governmental units can either operate or contract with a nonprofit organization to operate an urban homestead program. Act No. 131 would allow the state housing development authority to make loans to buyers and grants to resident organizations.

1999 PA 240 (effective 12/28/99) amends the Revised Judicature Act to provide that any action against a computer hardware or software designer, developer, or manufacturer that results from a Y2K computer date failure is an action solely in contract if:

a) the plaintiff hasn't suffered personal injury; and

b) the defendant has made a free repair or replacement available and has notified all registered buyers (or published notice in Michigan) of the possibly Y2K noncompliant article.

An action based on failure to detect or remediate a computer date failure brought against any person other than those named above would be deemed an action based solely in contract if the plaintiff has suffered no personal injury as a result of the Y2K failure.

1999 PA 239 (effective 12/28/99) limits the liability of a financial institution that made a good faith effort to make and implement a Y2K readiness plan to actual economic damages. The law does not apply to a wrongful death suit. It would prohibit foreclosure on a mortgage default caused by a computer date failure if the borrower timely notified the lender of the failure. Actions under the law must be commenced before January 1, 2001, and it sunsets on January 1, 2003.

Administrative Rule Amendments

The 1999 amendment to Secondary Mortgage Loan Act rules was instigated by 1997 amendments to the Secondary Mortgage Loan Act. These amendments incorporated the content of some administrative rules into statutory language, repealed the statutory basis for some other rules, and added an option for practitioners to "register" under the law rather than become licensed. The Secondary Mortgage rule amendments conform to the new statutory changes, adding appropriate references to "registrant," rescinding outdated rules and those incorporated into the statute, and easing requirements for record-maintenance. For the text of the revised rules, see the Bureau Web page: *http://www.cis.state.mi.us.*

FEDERAL LEGISLATION ENACTED

The **Gramm-Leach-Bliley Act (Public Law 106-102),** signed by the President on November 12, 1999, represents an historic agreement between the House and Senate, following two decades of debate, to repeal longstanding prohibitions against mixing commercial and investment banking.

The key provision of the measure allows banks, insurance companies and insurance firms to affiliate through "financial holding companies" under the supervision of the Federal Reserve. National banks will be permitted to own operating subsidiaries that engage in activities that are financial in nature (not including insurance underwriting, real estate investment and development, merchant banking, and insurance company portfolio investments).

The act establishes functional regulation as the framework for supervision of financial holding companies and the non-bank financial activities of operating subsidiaries.

It confirms the continued applicability of the McCarran-Ferguson Act relative to regulation of insurance by the states. Under the new law, states may not ''prevent or significantly interfere with'' affiliations between banks and insurance firms or with bank insurance activities.

Existing unitary thrift holding companies and those whose applications were submitted prior to May 4, 1999 are grandfathered by the new act. Looking into the future, though, it prohibits the sale of grandfathered unitary thrift holding companies to commercial firms.

In the **GLBA** Congress also addressed consumers' growing concerns about the privacy of their personal financial information. Public Law 106-102 requires disclosure of policies for collecting and protecting confidential information. It also requires institutions to allow consumers to opt out of information sharing with unaffiliated parties (except for consumer-initiated transactions, consumer reporting, examinations, and state and federal law compliance). It prohibits disclosure to third parties of credit card, savings and transaction account numbers for marketing purposes. Perhaps most important, it preserves state laws that provide consumers with greater privacy protection.

CRA reform was hotly debated in discussions on the measure. In the end, the Community Reinvestment Act was changed in three areas. First, the GLBA extended the period between CRA exams for small, well-run banks. Second, it requires banks and community groups to disclose CRA loan and grant agreements. Third, financial holding companies whose insured depository affiliates have less-than-satisfactory CRA ratings are prohibited from engaging in—or acquiring a firm that engages in—new financial activities.

Bureau Issuances

In 1999, the Bureau issued two declaratory rulings, several position statements, and one bulletin. These are available at the Bureau's Web site: *www.cis.state.mi.us/fib.*

DECLARATORY RULINGS

Authority to Use a Subsidiary to Conduct Real Estate Surveys—3/8/99

This declaratory ruling addressed whether Citizens First Savings Bank, Port Huron (Citizens), a state-chartered savings bank, is authorized under the Savings Bank Act (Act) to use a subsidiary to conduct real estate surveys in support of Citizens' real estate mortgage business. The Bureau found that neither the Act nor any other state law prohibits a savings bank or its subsidiary from performing real estate surveys. The Commissioner ruled that a Michigan state-chartered savings bank may own and operate a subsidiary that performs real estate surveys.

Financing of Negative Equity Under Motor Vehicle Sales Finance Act—4/23/99

In this declaratory ruling, the Commissioner considered whether an installment seller licensed under the Motor Vehicle Sales Finance Act may finance negative equity under an installment sale contract. The Commissioner found that the amount of negative equity on a motor vehicle traded in toward an installment purchase may be included in the cash price if the buyer and seller so agree in good faith. A dealer, therefore, could finance the negative equity as part of the agreed-upon cash price in connection with an installment sale of a motor vehicle.

POSITION STATEMENTS

Applicability of Usury Law to Certificate of Deposit—6/8/99

This position statement addressed whether a S&P-Linked Callable CD is a loan that is subject to the 25 percent ceiling in the Criminal Usury Act. The Bureau responded that, although the relationship between a bank and its depositor is legally that of creditor and debtor, it was unaware of anything in Michigan law indicating an intent to make usury laws apply to deposits.

Loan Processing Fee Under Secondary Mortgage Loan Act—6/8/99

In this position statement, the Bureau considered whether a lender licensed or registered under the Secondary Mortgage Loan Act (SMLA) may charge a five percent loan processing fee on the full amount of the credit line under a home equity line of credit contract and include the processing fee in the principal balance of the loan. The Bureau stated that section 22(1)(c) does not distinguish between closed-end and open-end second mortgage loans. A licensed or registered lender, therefore, may charge a processing fee of up to five percent of the amount of the home equity line-of-credit under the SMLA and may include the processing fee in the principal balance of the loan at the time of its execution.

Discount Points on Construction Loans—7/16/99

In this letter, the Bureau stated that a lender qualified to use the Depository Institutions Deregulation and Monetary Control Act of 1980 (DIDMCA) preemption of state law restrictions on points set forth in the Michigan Usury Act may charge a borrower discount points in sufficient number to buy down the interest rate on a construction loan to zero per cent. Under the loan program, the discount points would be financed and the balance of the construction loan would be rolled into the permanent mortgage loan. The Bureau stated that a DIDMCA-qualified lender could make this type of loan but cautioned that a lender initiating such a loan program would be well-advised to consider the risk exposure associated with the absence of cash flow during the indefinite term of the interim financing.

Post-Assignment Security Interest in Real Property Under Motor Vehicle Sales Finance Act—11/4/99

The Bureau issued this letter in response to a question asking whether a sales finance company licensed under the Motor Vehicle Sales Finance Act (MVSFA) offering a product enhancement to allow a customer to grant a security interest in his or her real property as additional security for the customer's installment sale contract (contract) would be subject to certain regulatory requirements. In its response, the Bureau stated that the MVSFA does not permit a licensed sales finance company, as assignee, to amend an existing contract by adding collateral security in the form of a lien against real property. The Bureau argued that section 12(a) and (b) of the MVSFA require that an installment sale contract must ''contain all of the agreements between the buyer and seller relating to the installment sale of the motor vehicle sold'' and contain ''all essential provisions'' before it is signed by the buyer. The form of property securing a contract is an essential provision. The contract, therefore, must contain any security interest taken by the seller before it is signed and later assigned to a licensed finance company.

Assignment Recording Fee Charged to Borrower—9/15/99

In response to the question of whether a lender can charge the borrower an assignment recording fee on the HUD [settlement statement] as part of a second mortgage transaction, the Bureau stated that, under section 22(b) of the Secondary Mortgage Loan Act (SMLA), the fees and charges paid by the borrower must be incurred ''in connection with the making, closing, disbursing, extending, readjusting, or renewing'' of a secondary mortgage loan, i.e., the charges and fees must be related to some part of the transaction between the lender and borrower. The Bureau argued that since the assignment transaction does not involve the borrower, the assignment recording fees do not occur in the making, closing, disbursing, extending, readjusting, or renewing of loans.

Applicability of Licensure Requirements to Foreign Industrial Loan Companies—10/1/99

The Bureau was asked to determine whether the licensing and registration requirements of the Mortgage Brokers, Lenders and Servicers Licensing Act (MBLSLA) and the Secondary Mortgage Loan Act (SMLA) apply to a FDIC-insured California industrial loan company (California ILC).

Section 25(a) of the MBLSLA expressly exempts a depository financial institution from the act. Section 29 of the SMLA, on the other hand, states that the act does not apply to ''a depository financial institution that is subject to other laws of this state, another state, or of the United States regulating the power of the depository financial institution to engage in secondary mortgage loan transactions.'' The Bureau stated that although a California ILC may be deemed to be a state bank under the Federal Deposit Insurance Act because of its deposit insurance, the MBLSLA specifically enumerates the institutions included within the definition of "depository financial institution.'' ILCs are not included within the definition. With regard to the SMLA, although the California ILC meets the definition of depository financial institution, it would not be able to take advantage of the section 29 exemption on transactions permissible under Michigan law but not regulated under California law without first obtaining a license or registering under the SMLA.

BULLETIN

MVSFA 99-001 (Negative Equity)—7/6/99

After issuing its declaratory ruling stating that a dealer licensed under the Motor Vehicle Sales Finance Act could finance negative equity in connection with an installment sale of a motor vehicle, the Bureau, on July 6, 1999, issued a bulletin addressing how dealers could disclose negative equity on installment sale contracts. The bulletin stated that in an installment sale contract involving negative equity, licensees must disclose certain items including the amount of negative equity financed in the installment sale contract. Included with the bulletin was a sample disclosure showing one acceptable format of disclosing negative equity on an installment sale contract.

FEDERAL ISSUANCES

FDIC Simplifies Deposit Insurance Rules for Joint and Payable-On-Death Accounts

On March 23, 1999, the Federal Deposit Insurance Corporation (FDIC) announced that it had revised the deposit insurance regulations governing joint accounts and payable-on-death (“POD” or revocable trust) accounts. The revisions were intended to simplify the FDIC’s regulations since consumers and bankers frequently misunderstood the existing regulations. Prior to the changes, calculation of FDIC insurance coverage involved a two-step process. For step one, all joint accounts owned by the same combination of people at an insured institution were added together and insured up to $100,000. Step two provided that each person’s shares in all joint accounts at that same institution were added together and insured up to $100,000. This meant that no one person’s insured interests in joint accounts could exceed $100,000. Thus, the insurance coverage for two people owning a $200,000 joint account was $100,000.

Under the new regulations, a person is insured up to $100,000 in total for his or her share of any joint accounts at an insured institution even if one of those accounts has a balance exceeding $100,000. Thus, if two people own a joint account amounting to $200,000 each person is insured for $100,000 on the joint account. A depositor’s ownership in joint accounts is covered up to $100,000 separately and in addition to the insurance available for other types of accounts, e.g., individual accounts, payable-on-death accounts, and retirement accounts.

On a payable-on-death account (commonly referred to as “POD,” “In Trust For,” or “Totten Trust” accounts), the depositor indicates that, upon his or her death, the funds will be payable to one or more named beneficiaries. The FDIC extended the list of qualifying beneficiaries from the owner’s spouse, children, or grandchildren to include the depositor’s parents and siblings. This means that a depositor who establishes a $300,000 account payable-on-death to a parent and two siblings will be insured up to the full amount on that account. The revisions took effect on April 1, 1999. The National Credit Union Administration adopted conforming changes, which took effect on April 22, 1999.

Federal Bank Regulators Withdraw Proposed "Know Your Customers" Regulations

At hearings held in the first week of March, federal bank regulators announced that, in response to an unprecedented level of negative comment, they would withdraw their proposed "Know Your Customer" regulations. The proposed regulations, issued in late 1998 by the four federal bank and thrift regulators, were intended for banks and thrifts to establish formal "Know Your Customer" programs. Proponents of the proposed regulations saw them as an effort to help banks identify persons involved in money laundering. In the four-month comment period, the FDIC alone received over 254,000 letters protesting the proposed regulations and just 72 supporting them.

The Federal Reserve System Proposes Revisions to Official Staff Commentary of Regulation Z to Address "Payday Loans"

On November 3, 1999, the Federal Reserve Board published proposed changes to the official staff commentary to clarify whether "payday loans" constitute credit for purposes of the Truth in Lending Act (TILA). The proposed revision clarifies that payday loan transactions constitute credit under the TILA. Persons that regularly extend such loans and impose a finance charge are required to provide TILA disclosures to consumers.

House Banking Committee Rejects Exam Fees

On February 25, 1999, the House Banking Committee met to consider budget items including a proposal to charge new federal examination fees for bank holding companies and state-chartered banks. The Committee again rejected imposition of the new fees as a "bad idea."

Federal Regulators Issue Guidelines on Subprime Lending

On March 3, 1999, the Federal Deposit Insurance Corporation (FDIC), the Board of Governors of the Federal Reserve System, the Office of the Comptroller of the Currency, and the Office of Thrift Supervision jointly issued Interagency Guidelines on Subprime Lending. The guidelines remind banks of the risks inherent in subprime lending and outline the types of controls the agencies expect banks to have in place before conducting this type of lending. Noting that some experienced non-bank subprime lenders had suffered losses in recent months, the guidelines cautioned that an economic downturn would affect subprime borrowers earlier and more severely than low risk borrowers. Management should evaluate whether embarking on this type of lending program would be prudent during the current phase of the economic cycle. Finally, the guidelines warned that the agencies might impose higher minimum capital requirements on banks engaged in subprime lending and, if the risks are not properly controlled, the bank's lending program may be considered unsafe and unsound.

Securities and Exchange Commission (SEC) and Federal Bank Regulatory Agencies Attempt to Settle Dispute Over Loan Loss Reserves

In 1999, the SEC and federal bank regulators attempted to promote a clearer understanding of loan loss reserves in order to end months of mixed and confusing signals. Positions taken by the SEC and the federal banking agencies on this subject have often been at odds. The dispute pits the SEC, which favors strict adherence to standards of the Financial Accounting Standards Board against the bank and thrift regulators, whose chief focus is to prepare for deteriorating loan quality and economic weakness. The SEC opposes use of loan loss reserves to manage earnings. Earnings management occurs when a bank builds up reserves during good economic times, which reduces reported earnings. The additional reserves serve as a funds source to be tapped during downturns to boost profits.

During the week of July 16, the SEC and the federal bank regulatory agencies released a joint letter to banks and thrifts summarizing principles relating to loan loss reserves. The federal agencies agreed that determining an appropriate allowance requires a high degree of management judgment and results in a range of estimated losses and prudent, conservative, but not excessive, loan loss allowances that fall within a range of estimated losses are appropriate. A bank, in accordance with GAAP, should record its best estimate within the range of estimated losses. The agencies recognized that determining the allowance for loan losses is imprecise and that allowance estimates should be based on a comprehensive, well-documented, and consistently applied analysis of the loan portfolio. The loan loss allowance should consider all available information including industry, geographical, economic, and political factors.

Financial Crimes Enforcement Network Issues Money Services Business Regulations

On August 18, 1999, the Treasury Department announced publication of a final regulation requiring that money services businesses (MSBs) register with its Financial Crimes Enforcement Network (FinCEN) in order to strengthen anti-money laundering controls within such businesses. MSBs, which include money transmitters, issuers, redeemers, and sellers of money orders and travelers checks, check cashers and currency retail exchangers, accounted for $200 billion in financial transactions in 1996. These businesses are largely unregulated and, in some cases, have been used to launder large amounts of money from unlawful enterprises and evade the requirements of the Bank Secrecy Act.

The regulation requires that by December 31, 2001, MSBs register with the Department of Treasury and maintain a list of their agents for examination by any appropriate law enforcement agency. Entities excluded from the regulation are depository financial institutions, parties that do not conduct money transmission services as a primary business activity, persons registered with and regulated by the SEC or the Commodity Futures Trading Commission, parties that conduct money services transactions in a dollar amount below $1,000 daily, and persons which are issuers, sellers, or redeemers of stored value products.

SIGNIFICANT LITIGATION

Patrick M. McQueen v. Eugene A. Ludwig, first discussed in the Bureau's 1996 Annual Report, was resolved in May when the United States Court of Appeals for the Sixth Circuit reversed the district court's decision and directed the lower court to grant summary judgment in favor of the Commissioner.

You may recall that in February, 1996 the Commissioner brought an action in Federal District Court challenging a decision of the Comptroller of the Currency that enabled Society Bank-Michigan concurrently to convert to a national bank, relocate its main office to Bronson, Michigan, and merge with Society National Bank-Indiana—and to retain all existing branches and office locations of each of the constituent banks. The Commissioner contended that Society Bank's plan, and the OCC's permission to execute it, violated the National Bank Act, the McFadden Act, and branching provisions of the Riegle-Neil Act of 1995.

The District Court ruled that the National Bank Act did not require a converting bank to designate a particular location as its main office and did not require a bank to designate its principal office under state law as its main office. Since the statute does not address the issue, the Court viewed its task as limited to determining whether the Comptroller's interpretation was a reasonable interpretation of the statute and ruled that the Comptroller's decision was reasonable. The Bureau appealed the ruling to the United States Court of Appeals for the Sixth Circuit.

In overturning the District Court's ruling, the Sixth Circuit Court concluded, referring to the Comptroller's approvals: ''The complex applications and master plan involved propose instantaneous steps and maneuvers that would equal the actions of a Fred Astaire or a Gene Kelley.'' The lower court was directed to grant summary judgment in favor of the Commissioner.